

Summary of Advanced Management Programme (AMP) Project Report

“Role of Regional Rural Banks in the Indian Financial System: A Contemporary Analysis”

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Established as specialized financial intermediaries, Regional Rural Banks (RRBs) have been integral to India's strategy for fostering financial inclusion and equitable rural development for nearly five decades. This study undertakes a critical evaluation of the contemporary role and operational efficacy of RRBs within the Indian financial system. It seeks to analyze their contribution to rural credit dissemination, mobilization of savings and the facilitation of sustainable economic growth in hinterlands. Utilizing a mixed-method approach, the study synthesizes quantitative analysis of secondary financial data from regulatory bodies with qualitative insights derived from primary surveys of RRB stakeholders. The study confirms the pivotal role of RRBs in extending financial services to small and marginal farmers, agricultural labourers and rural artisans, thereby, acting as crucial conduits for Government development schemes and empowering Self-Help Groups (SHGs).

However, the analysis also illuminates significant operational and strategic challenges confronting these institutions. These include persistent issues with asset quality in specific sectors, sub-optimal adoption of digital banking technologies by their target clientele and demonstrable gaps in financial literacy and credit counselling outreach. Despite these impediments, the financial performance of the RRBs has exhibited a robust positive trajectory in recent years, marked by record profitability, improved asset quality and an enhanced credit-deposit ratio. A key finding revealed a potential concentration risk in the loan portfolios of several RRBs heavily

skewed towards SHG financing. The study concludes with a set of strategic recommendations aimed at policymakers and RRB management, focusing on enhancing digital penetration, streamlining service delivery, diversifying credit portfolios and reinforcing their foundational role as catalysts for a financially empowered and resilient rural India.

Introduction

The architectural design of India's financial system has historically grappled with the challenge of a persistent urban-rural dichotomy. Despite significant strides in banking sector development post-independence, a vast swathe of the nation's rural populace remained systematically excluded from the formal financial ecosystem. This exclusion was not merely a matter of geographical distance but a complex socio-economic barrier that stifled rural potential, perpetuated cycles of debt and widened economic disparities. In response to this structural lacuna, the Government of India, acting on the seminal recommendations of the Narasimham Working Group, conceptualized a new class of financial institution - the Regional Rural Bank.

The first five RRBs were established on October 2, 1975, under the legislative framework of the RRB Act, 1976. The core philosophy underpinning their creation was to forge a synergistic hybrid institution that married the local familiarity and grassroots connect of co-operative banks with the professional management and financial robustness of commercial banks. Their mandate was explicit: to serve as dedicated vehicles for delivering credit and other banking services to the most marginalized segments of rural society - small

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and marginal farmers, agricultural labourers and rural entrepreneurs.

Over the ensuing decades, RRBs have evolved into an indispensable component of the rural credit delivery mechanism. Their journey, however, has been characterized by both commendable successes and formidable challenges. They have been instrumental in mobilizing rural savings, extending credit for productive purposes and acting as the primary interface for the Government's Direct Benefit Transfer (DBT) schemes. Concurrently, they have contended with issues of financial viability, operational inefficiencies, mounting Non-Performing Assets (NPAs) and the imperative of technological adaptation in an increasingly digitized world. As India navigates a dynamic economic landscape shaped by digital transformation and a renewed policy focus on inclusive growth, a comprehensive reassessment of the role, relevance and strategic direction of RRBs is both timely and imperative. This study aims to provide such an in-depth, evidence-based analysis of their contemporary position within the Indian financial system.

Objectives of the Study

The overarching objective of this study was to conduct a holistic evaluation of the role and impact of Regional Rural Banks (RRBs) in the promotion of financial inclusion, the facilitation of rural credit accessibility and the stimulation of sustainable economic development within the broader framework of the Indian financial system. This primary goal anchors the study in a critical assessment of the effectiveness, evolution and systemic integration of RRBs.

To achieve this comprehensive aim, the study pursued a set of specific and delineated objectives:

- To trace the historical evolution and examine the foundational policy rationale behind the establishment of RRBs in India.
- To evaluate the operational and financial performance of the RRB sector, with a particular focus on the last two decades, analyzing key performance indicators such as capital adequacy, asset quality, profitability and productivity.

- To critically assess the specific role of RRBs in promoting financial inclusion and deepening rural credit delivery, including their participation in Government-sponsored schemes.
- To identify and analyze the primary challenges and operational constraints - including technological, human resource and regulatory impediments - faced by RRBs in the effective fulfilment of their mandate.
- To conduct a detailed analysis of the business portfolio of RRBs, examining its composition both segment-wise and product-wise, with a focused investigation into the Self-Help Group (SHG) loan portfolio and its implications.
- To analyse the role played by RRBs in the market for Priority Sector Lending Certificates (PSLCs) as a mechanism for revenue generation and risk management.
- To formulate a set of strategic and data-driven recommendations for policymakers, regulatory bodies and the management of RRBs to strengthen their institutional capacity and enhance their efficacy as agents of inclusive rural finance.

Research Methodology

To ensure a rigorous and multifaceted investigation into the complex role of RRBs, the study employed a mixed-method research methodology. This approach facilitates the triangulation of findings by integrating quantitative financial analysis with qualitative stakeholder perceptions, thereby, providing a more nuanced and holistic understanding of the subject.

The quantitative component involved an extensive analysis of secondary data. The main sources for this data were the official annual publications of the National Bank for Agriculture and Rural Development (NABARD), including "Key Statistics of RRBs," published annual reports of concerned RRBs and various reports from the Reserve Bank of India (RBI), such as the "Report on Trend and Progress of Banking in India." This longitudinal data, spanning over a decade, was utilized to analyze trends in the financial performance, asset quality, credit deployment and productivity of the RRB sector as a whole.

The qualitative component was designed to capture the experiential dimensions of RRB operations and was based on the collection of primary data. A structured survey questionnaire was administered to a stratified sample of RRB customers across different regions to gauge their awareness of services, satisfaction levels, digital banking adoption and perceptions of service quality. The sample included farmers, small business owners and members of Self-Help Groups to ensure a diverse representation of the RRB clientele. In addition, semi-structured interviews were conducted with Branch Managers and Senior Officials from RRBs to gather insights into operational challenges, strategic priorities and institutional perspectives.

The data analysis was conducted in two phases. Quantitative data were analyzed using descriptive statistics to identify trends and patterns in key financial indicators. The primary survey data were analyzed using simple percentage analysis and graphical representations to interpret customer feedback. Qualitative data from interviews were subjected to thematic analysis to identify recurring themes and critical insights. The synthesis of these two analytical streams forms the foundation of the findings and recommendations presented in the study.

The Institutional Profile of RRBs

Regional Rural Banks (RRBs) represent a unique tier in India's banking structure, conceived specifically to address the credit gaps in rural areas. Their institutional framework is defined by a tripartite ownership model where the equity is held by the Central Government (50%), the concerned State Government (15%) and a Sponsor Bank (35%), which is normally a Public Sector Bank. This structure is designed to leverage the broad policy direction of the Central Government, the localized developmental priorities of the State and the banking expertise of the sponsor institution.

The genesis of RRBs in 1975 was a direct policy response to the realization that neither commercial banks, with their urban orientation, nor co-operative banks, with their managerial and financial weaknesses, were adequately equipped to meet the credit demands of the rural poor. The primary objectives enshrined in the RRB Act, 1976, were two-

fold: first, to provide credit and other banking facilities, especially to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs; and second, to mobilize rural savings and channel them into productive activities within their area of operation.

Over the years, the RRB landscape has undergone significant structural transformation. Recognizing the challenges of operational fragmentation and financial non-viability that plagued the initial large number of standalone RRBs (196 at their peak), the Government of India initiated a phased process of amalgamation in 2005. This consolidation, based on the principle of "One state, One sponsor bank" (with some exceptions), aimed to create larger and more robust RRBs with enhanced scale, improved operational efficiency and stronger financial footing. This has resulted in the number of RRBs being rationalized to 43 as of March 2023.

NABARD functions as the apex supervisory authority for RRBs, providing them with policy guidance, inspection oversight and crucial refinancing support to augment their resource base for lending. This comprehensive regulatory and ownership framework positions RRBs as critical instruments of public policy, tasked with the dual mandate of pursuing commercial viability while simultaneously fulfilling their social objective of inclusive rural development.

Financial Performance of Regional Rural Banks

A granular analysis of the financial statements of RRBs reveals a sector that has navigated significant challenges to emerge with enhanced financial strength and operational resilience in recent years. The consolidated financial position as of 31st March, 2023 underscores this positive trajectory.

- **Balance Sheet Growth:** The consolidated balance sheet of the 43 RRBs expanded by 9.4% during FY 2022-23, reaching an aggregate size of ₹7.71 lakh crore. This growth was propelled by healthy expansion on both the liabilities and assets side.
- **Owned Funds:** The owned funds of RRBs, comprising share capital and reserves, grew by a robust 16.5% to ₹57,356 crore, bolstered by

capital infusion from stakeholders and internal accruals from profits.

- **Deposits:** Deposits remain the primary source of funds, constituting 78.9% of total resources. Aggregate deposits grew by 8.2% to reach ₹6.08 lakh crore. A significant strength of the RRB deposit portfolio is its high share of low-cost Current Account and Savings Account (CASA) deposits, which stood at 54.5%. This is higher than the CASA ratios of Public Sector Banks (42.1%) and Private Sector Banks (45.0%), providing RRBs with a stable and low-cost source of funding. While RRBs account for only 3.2% of the total deposits of all Scheduled Commercial Banks (SCBs), they service a disproportionately high 13.7% of the total deposit accounts, attesting to their deep penetration among small savers.
- **Borrowings:** Borrowings grew by 14.7% to ₹84,712 crore, with RRBs increasingly diversifying their funding sources beyond NABARD and Sponsor Banks to include institutions like Micro Units Development & Refinance Agency Ltd. (MUDRA).
- **Investments:** The investment portfolio grew by 6.0% to ₹3.13 lakh crore. The majority of these investments were held in Statutory Liquidity Ratio (SLR) securities (67.0%) and term deposits with other banks (29.6%).
- **Loans and Advances:** The gross loan portfolio registered a strong growth of 13.2%, reaching ₹4.11 lakh crore. This credit expansion was primarily directed towards the Priority Sector, which constituted 88.3% of the total advances. Within this, the agriculture sector was the largest recipient, accounting for 68.6% of the total loan book, reaffirming the RRBs' commitment to their core mandate.
- **PSLC Transactions:** RRBs have adeptly utilized the Priority Sector Lending Certificates (PSLCs) market to monetize their surplus in priority sector lending. In FY 2022-23, the total volume of PSLCs traded by RRBs increased by 27.9% and their share in the overall PSLC market rose to an impressive 41.7%, yielding a net income of ₹2,741 crore.
- **Ground Level Credit (GLC) flow:** RRBs disbursed ₹2.42 lakh crore towards agriculture in FY 2022-23, an 18.7% increase over the previous year. Their share in the total agricultural GLC stood at 11.2%.
- **Agricultural Credit achievement:** Against a target of ₹2.20 lakh crore for agricultural credit in FY 2022-23, RRBs achieved a disbursement of ₹2.42 lakh crore, representing an achievement rate of 110%.
- **Profitability:** The profitability of the RRB sector has witnessed a remarkable turnaround. After incurring losses in FY 2018-19 and FY 2019-20 (primarily due to the provisioning for pension liabilities), the sector has been consistently profitable. In FY 2022-23, RRBs posted their highest-ever consolidated net profit of ₹4,974 crore, a year-on-year growth of 54.5%. A total of 37 out of 43 RRBs were profitable during the year.
- **Asset Quality:** There has been a significant improvement in the asset quality of RRBs. The consolidated Gross Non-Performing Assets (GNPA) ratio declined from 9.1% in March 2022 to 7.3% in March 2023, its lowest level in seven years. The Net NPA (NNPA) ratio also improved substantially, falling from 4.7% to 3.2% over the same period. The Provision Coverage Ratio (PCR) strengthened from 52.0% to 59.2%.
- **Productivity:** Both per-branch and per-employee productivity metrics have shown consistent improvement. Business per branch increased to ₹46.3 crore, while business per employee rose to ₹11.1 crore as of March 2023.
- **Credit-Deposit (CD) Ratio:** Reflecting a more efficient deployment of resources, the consolidated CD ratio improved to 67.5% as of March 2023, the highest level recorded in over 15 years.
- **Performance in Government Schemes:** RRBs continue to play a pivotal role in the implementation of the Government's flagship financial inclusion schemes. Their share in the cumulative enrolments under schemes like Pradhan Mantri Jan Dhan Yojana (PMJDY) and Atal Pension Yojana (APY) stood at 18.8%, a

figure that far surpasses their ~3% share in the total business of the banking system.

- **SHG Financing:** RRBs have played a significant role in the SHG-Bank Linkage Programme pioneered by NABARD. As on 31 March, 2023, 40.48 lakh SHGs were savings linked with RRBs having total savings of ₹18,203 crore as compared to 35.83 lakh SHGs with total savings of ₹13,791 crore as on 31 March, 2022, maintaining agency-wise share of 30% in total SHGs savings linked to banks. Further, 15.70 lakh SHGs were credit linked during 2022-23 as compared to 11.05 lakh SHGs during 2021-22 by RRBs with an agency-wise share of 37%. The NPA as percentage to loans to SHGs for RRBs stood at 2.48% as on 31 March, 2023 as compared to 3.14% and 3.99% as on 31 March, 2022 and 31 March, 2021, respectively.

Data Analysis and Interpretation

The primary data collected through surveys with rural customers provides crucial context to the financial data, revealing the on-the-ground realities of the RRB-customer interface.

The analysis indicates a high level of institutional awareness, with 90% of respondents (40% fully aware, 50% partially aware) cognizant of the existence and services of RRBs. This suggests that RRBs have successfully established a strong physical and mental presence in their operational areas. However, the utilization of their services is heavily skewed towards traditional products. While savings accounts are used by a majority (60%), more complex products like agricultural loans (30%) and insurance (10%) are significantly underutilized. This points to a potential gap in product awareness, accessibility or suitability for the target clientele.

Customer satisfaction, a key metric of service quality, was found to be largely moderate (70%). While this indicates that RRBs are meeting basic banking needs, the low percentage of “highly satisfied” customers (20%) suggests a deficit in delivering an exceptional customer experience. Key areas for improvement likely lie in service efficiency, transparency and responsiveness.

A critical finding emerges in the domain of digital banking. A significant 50% of respondents are only partially aware of digital channels and 20% are completely unaware. This knowledge gap translates into low adoption, with cash remaining the dominant transaction mode for 40% of users. The combined usage of mobile and internet banking stands at only 30%, highlighting persistent barriers related to digital literacy, handset availability, internet connectivity and perceived security risks.

The timeliness of credit delivery remains a significant operational challenge. A majority of loan-availing respondents (50%) reported experiencing delays in disbursement, with a further 10% stating their loan was not disbursed at all. Such delays can have severe adverse consequences for rural borrowers, particularly in agriculture, where credit needs are time-sensitive. This points to inefficiencies in loan appraisal, documentation and sanctioning processes that require urgent attention.

In contrast, the human element of service delivery emerged as a distinct strength. A substantial 50% of customers reported that the behaviour of branch staff was “highly influential” in their decision to continue their banking relationship. This underscores the importance of courteous, empathetic and supportive staff in building trust and loyalty in rural communities. However, the study also revealed a concerning lack of engagement with crucial value-added services. An alarming 70% of respondents had never attended a financial literacy program and half were unaware of any available credit counselling services. This represents a significant missed opportunity for RRBs to empower their customers with financial knowledge and advisory support.

Major Findings of the Study

The synthesis of quantitative financial analysis and qualitative stakeholder feedback yields several major findings that encapsulate the current state of RRBs in India.

First, RRBs have unequivocally succeeded in their primary mission of financial outreach. Their high share of deposit accounts relative to their balance sheet size, their dominant role in implementing

Government financial inclusion schemes and their deep penetration in rural areas confirm their status as vital institutions for last-mile delivery of banking services and products.

Second, the financial health of the RRB sector has demonstrably improved. The turnaround in profitability, consistent reduction in NPAs and strengthening of the CD ratio point to enhanced operational efficiency and better risk management practices, likely driven by the benefits of amalgamation and focused supervisory oversight by NABARD.

Third, despite their institutional strengths, RRBs face a significant challenge in transitioning their customer base to digital platforms. The low adoption of digital banking represents a critical bottleneck that not only limits operational efficiency but also risks leaving rural customers behind in an increasingly digital financial ecosystem.

Fourth, service delivery, particularly in the domain of credit, is hampered by procedural inefficiencies. The prevalence of delays in loan disbursement is a major pain point for customers and undermines the core objective of providing timely credit.

Fifth, the study identifies a potential concentration risk in the loan portfolios of certain RRBs. RRBs concentration in SHGs financing ranges from 1.59% to 59.07% of total loans and advances. Five RRBs viz: Uttar Banga Kshetriya Gramin Bank (46.21%), Pashchim Banga Gramin Bank (48.28%), Bangia Gramin Bank (59.07%) (All three RRBs in West Bengal), Jharkhand Rajya Gramin Bank (26.74%) and Odisha Gramya Bank (32.95%) have SHG loan outstanding more than 25% of their total loans and advances. While the asset quality of the SHG portfolio is currently excellent (NPA of 2.48%), this over-reliance on one sector creates a vulnerability to any systemic shocks that may affect the microfinance environment, necessitating a strategic push towards portfolio diversification.

Given that a significant portion of the total loans and advances for several Regional Rural Banks (RRBs) is concentrated in Self-Help Group (SHG) financing, a notable concentration risk emerges. This heavy concentration exposes these RRBs to

potential adverse impacts stemming from changes in Government policies related to SHGs, fluctuations in the repayment capacity of SHG members due to economic downturns or social issues and systemic risks affecting the microfinance ecosystem in these regions.

Sixth, there is a profound gap in the provision of financial literacy and advisory services. The low participation in and awareness of these programs indicate that RRBs are not fully leveraging their position to build the financial capabilities of their customers, which is a critical component of sustainable financial inclusion.

Recommendations

To address the identified challenges and build on their inherent strengths, the following strategic recommendations are proposed for RRBs, their sponsor banks and regulatory and supervisory authorities:

Spearhead a Hyper-Localized Digital Literacy

Mission: Instead of generic awareness campaigns, RRBs should design and implement hands-on, hyper-localized digital literacy modules in local dialects. These should be conducted in collaboration with village panchayats and SHGs. Introducing “digital tutors” at branches to provide assisted onboarding and transaction support can help overcome initial inertia and build user confidence.

Re-engineer Credit Delivery Processes: To tackle delays in loan disbursement, RRBs must urgently re-engineer their credit processes. This should involve simplifying application forms, adopting digital land record verification wherever available and implementing a robust and transparent loan application tracking system. Setting and monitoring strict Turnaround Times (TATs) for different loan products should be a key performance metric.

Mitigate Concentration Risk through Strategic Portfolio Diversification: RRBs with high exposure to SHG financing must adopt a formal board-approved policy for mitigating concentration risk. This policy should establish internal prudential limits on sectoral exposure. To operationalize this, RRBs must focus on strategic diversification by:

- **Developing Customized Products:** Create tailored credit products for non-SHG segments such as Joint Liability Groups (JLGs) of tenant farmers, rural artisans and individual financing for agri-allied activities (e.g. dairy, poultry, fisheries).
- **Promoting “SHG Graduation”:** Establish a clear pathway for mature and successful SHG members to “graduate” to individual micro-enterprise loans under schemes like MUDRA. This transition helps build individual credit histories and creates a new more diversified asset class.
- **Building Staff Capacity:** Invest in training and capacity building for branch-level staff to equip them with the necessary skills for appraising a wider range of credit proposals, including those from Micro, Small and Medium Enterprises (MSMEs) and rural retail sectors, which require different assessment methodologies than group-based lending.
- **Forging Strategic Partnerships:** Collaborate with local entities like Krishi Vigyan Kendras (KVKs), MSME Development Institutes and Farmer Producer Organizations (FPOs) to generate a quality pipeline of lending opportunities in diverse rural economic activities.

Institutionalize Financial Literacy and Credit Counselling: Financial literacy cannot be an ancillary activity; it must be institutionalized. RRBs should be mandated to conduct a minimum number of financial education camps per branch per quarter. Furthermore, credit counselling services should be proactively offered and publicized, especially to first-time borrowers and those showing early signs of repayment stress.

Invest in Human Capital and Customer Service Excellence: Recognizing that the human interface is a key differentiator, RRBs should invest continuously in training their staff not only in banking operations but also in customer relationship management, communication and digital banking tools. A

performance management system that gives significant weightage to customer satisfaction metrics can further enhance service quality.

Conclusion

In conclusion, Regional Rural Banks remain fundamentally crucial to the architecture of India's rural financial system. They have successfully carved a niche as trusted, accessible and community-centric institutions that serve as the primary banking touchpoint for millions of rural households. The findings of the study affirm their significant contributions to financial inclusion, credit delivery to priority sectors and the effective implementation of Government welfare schemes. The recent improvements in their financial performance underscore a growing institutional resilience and operational maturity.

However, the journey ahead requires a strategic pivot. The challenges of inadequate digital adoption, persistent inefficiencies in credit delivery and a significant deficit in financial advisory services are not trivial; they represent critical barriers to unlock the full potential of these institutions. The identified concentration risk in the loan portfolios of some RRBs also calls for prudent strategic realignment.

The future effectiveness of RRBs will be contingent on their ability to navigate a dual transformation: an internal transformation focused on enhancing operational efficiency, technological integration and human capital development; and an external transformation focused on empowering their customers to participate fully in a modern, digital economy. By embracing the recommendations outlined—from spearheading digital literacy and re-engineering credit processes to diversifying portfolios and institutionalizing financial education—RRBs can evolve from being mere credit purveyors to becoming comprehensive financial wellness partners for rural India. Their continued evolution is not just an institutional goal but a national imperative for building a truly inclusive, resilient and empowered rural economy.

